



8011-01p  
SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-66021; File No. SR-FINRA-2011-063)

December 21, 2011

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving Proposed Rule Change Relating to Amendments to the Order Audit Trail System Rules

I. Introduction

On October 28, 2011, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to amend its Order Audit Trail System (“OATS”) rules to require certain information be reported to OATS and to specify the time OATS reports must be transmitted to FINRA. Notice of the proposal was published for comment in the Federal Register on November 10, 2011.<sup>3</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposal

FINRA is proposing to amend (i) FINRA Rules 5320 and 7440 to require that members report to OATS, information barriers put into place by the member in reliance on Supplementary Material .02 to FINRA Rule 5320; (ii) FINRA Rule 7440 to require that members report customer instructions regarding the display of a customer’s limit order in any OATS-eligible security; and (iii) FINRA Rule 7450 to codify the specific time OATS reports must be transmitted to FINRA.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 65692 (Nov. 4, 2011), 76 FR 70195.

## (1) Customer Order Protection

First, FINRA is proposing to require members to identify on OATS reports information barriers that the member has in place to permit the member to qualify for the No-Knowledge Exception in Supplementary Material .02 to FINRA Rule 5320. Under FINRA Rule 5320, a member that accepts and holds an order in an equity security from its own customer, or a customer of another broker-dealer, without immediately executing the order is prohibited from trading that security on the same side of the market for its own proprietary account at a price that would satisfy the customer order unless the member immediately thereafter executes the customer order up to the size and at a price that is the same as, or better, than the price at which the member traded for its proprietary account.

The No-Knowledge Exception in Supplementary Material .02 to FINRA Rule 5320 provides, in part, that with respect to NMS stocks, if a firm implements and uses an effective system of internal controls—such as appropriate information barriers—that operate to prevent one trading unit from obtaining knowledge of customer orders held by a separate trading unit, those other trading units may trade in a proprietary capacity at prices that would satisfy the customer orders held by the separate, walled-off trading unit. Supplementary Material .02 to FINRA Rule 5320 also contains an additional No-Knowledge Exception for OTC equity securities. The proposed rule change would amend FINRA Rules 5320 and 7440 to require firms relying on the No-Knowledge Exception to identify the information barriers to FINRA in their OATS reports.

## (2) Limit Order Display

FINRA Rule 7440(b)(14) requires OATS Reporting Members to identify “any request by a customer that an order not be displayed, or that a block size order be displayed, pursuant to

Rule 604(b) of SEC Regulation NMS.” These customer requests are identified in the OATS system through a “Customer Instruction Flag” that indicates whether the customer has requested that the firm handle its limit order in a specified way. Because of the reference in FINRA Rule 7440(b)(14) to SEC Regulation NMS, members are only required to populate the Customer Instruction Flag when the order involves a security subject to SEC Regulation NMS.

On June 22, 2010, the Commission approved FINRA Rule 6460,<sup>4</sup> which became effective on May 9, 2011.<sup>5</sup> FINRA Rule 6460 generally requires OTC market makers to display a customer limit order in an OTC equity security held by the OTC market maker that is at a price that would improve the bid or offer of the OTC market maker in the security or that would represent more than a de minimis change in relation to the size associated with the OTC market maker's bid or offer. FINRA Rule 6460(b) includes exceptions to the display requirement for OTC equity securities that mirror the exceptions in Rule 604(b) of SEC Regulation NMS.<sup>6</sup>

FINRA is proposing to require that OATS Reporting Members indicate on all OATS reports for customer limit orders, including for OTC equity securities, whether the customer has instructed the member not to display the limit order or to display a limit order of block size. As a result, OATS Reporting Members would be required to populate the Customer Instruction Flag for all limit orders, not just those involving NMS stocks.

### (3) Order Data Transmission Requirements

FINRA Rule 7450 requires members to report order information recorded pursuant to FINRA Rule 7440. Paragraph (a) of the rule imposes the general requirement that members

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<sup>4</sup> See Securities Exchange Act Release No. 62359 (June 22, 2010), 75 FR 37488 (June 29, 2010).

<sup>5</sup> See Regulatory Notice 10-42 (September 2010).

<sup>6</sup> See FINRA Rule 6460(b)(2), (b)(4).

report applicable order information to FINRA that the member is required to record by FINRA Rule 7440. Paragraph (b) of the rule addresses the form the order data must take and the timing of order reports. Paragraph (c) concerns the use of reporting agent agreements that a member may use to allow a third party to report information to OATS on behalf of the member. The proposed rule change amends paragraph (b) of FINRA Rule 7450 to codify the specific time OATS reports must be transmitted to FINRA, which is the same time that currently is required under the OATS Reporting Technical Specifications.

Under the proposed rule, all order events that occur on a particular OATS Business Day must be transmitted to FINRA by 8:00 a.m. Eastern Time on the calendar day following the end of the OATS Business Day. For purposes of the rule, an “OATS Business Day” begins at 4:00:01 p.m. Eastern Time on one market day and ends at 4:00:00 p.m. Eastern Time on the next market day.<sup>7</sup> FINRA is retaining the exception for information that is not available by the time the report must be transmitted; in such cases, the report must be transmitted on the day that the information becomes available.

The effective date of the proposed rule change will be no later than 120 days after Commission approval.

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national

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<sup>7</sup> Thus, for example, assuming no holidays, if an order is received at 5:00:00 p.m. Eastern Time on Wednesday, the order event occurs on the OATS Business Day ending Thursday at 4:00:00 p.m. Eastern Time. Receipt of the order (and any subsequent event(s) regarding the order until Thursday at 4:00:00 p.m. Eastern Time) must be reported by 8:00:00 a.m. on Friday. Order events occurring on market days during regular market hours (i.e., before 4:00:01 p.m. Eastern Time) are reported by 8:00:00 a.m. Eastern Time on the following calendar day.

securities association.<sup>8</sup> In particular, the Commission finds that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest as the changes should make FINRA's surveillance more efficient.

The proposed rule change should make FINRA's surveillance more efficient because both the existence of information barriers and the customer's instructions regarding the display of limit orders for all OATS securities will be captured in OATS, so that such transactions will not create "false positive" results that FINRA must review to ensure that the transactions do not violate the rule. This should enable FINRA to focus its resources on transactions that are not permitted under the rules. The Commission believes that codifying the time by which OATS reports must be submitted should provide greater clarity to FINRA members of their reporting obligations under the rules.

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<sup>8</sup> In approving this rule proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78d-3(b)(6).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-FINRA-2011-063) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>11</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).